

EXHIBIT B

ERIN STOLING LLP

Naudie's Inc.
May 14, 1999
Audit Committee Meeting

MAC
5/14/99
L 6/3/99

<u>E+Y</u>	<u>client</u>
Present: C. Gebbia	Neil Cole. Bob Mittman } Tencer
J. David	L. O'Shaughnessy Ethan Seer } Greenub
L. Scerra	Clifford (Hau) (B&Counsel) Deborah Sorrell
A. Caporale	M. Tucker (speaker) David Golden
	B. Brumman
	J. Papernik (B&Counsel)

Lou opened mtg.

1. Status of audit - Performed many procedures, not completed or signed off - Open areas are:
Barter transactions, Reduced credits +
grossly analysis, F/S + F/N, debt arrangement
covenants, Bongo royalty questions,
Will cont. to do search for unrecorded
liab, subs. CR for chybik w/o's, updates
for CCM on inventory.

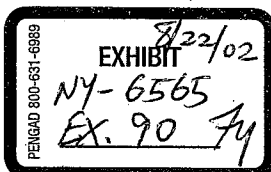
2. Transactions

A. Barter - Rev. Recognition, valuation issues.

Various barter trans. - Lucky, slides in 98,
slides in 99, 10/98 sale transaction.

10/98 - Co. sold certain shoes to Intrac for ~\$19/pair
Q3 recorded \$600K (#3/pair) in prior 98, 99 trans.

\$1.2M. sale for shoes. - Economic substance
is "curious" as Co. has sales orders @ 13-14
but barter gives them \$19/pair - Acceleration
of revenue to Q3 from Q4 when ultimately
shipped. After inquiring of transaction, shoes
stored in trailers - BOC dated 10/98, Intrac
didn't accept goods, retr'd in Q4 + sale
reversed.



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-Invoice has carton qty's of 4200, ret'd receiving report has 4200, BOL's have ~5100 - 900 carton unknown as to status

-Trans. draws question from economic substance, rev. recognition & gty. amts.

FY98 Transactions

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(A) Lucky shoes sold to Intrac, rec'd credits, and credits used in FY99. Shoes sold out of country. Transaction seemed appropriate w/in ~~country~~ FY but unsure as to timing w/in yr & Qtr reporting since no BOL's available.

(B) Slide shoes - sold for cash & credits ~133K shoes @ \$600 of cash and \$700K+ credits. No BOL's/freight bills. During FY99 the cash portion was changed ~~to~~ to credits. To be sold o/s US - however, sold inside US. Difficulty in valuing transaction. Trans. diff. than PJ. in that cash went away. Increased skepticism in valuation of transaction. ?? is value of bates credits - Joel Papernik asked if Intrac does this type of transaction & if common - J. David said not unheard of. Some Co's do it and others don't. Intrac confirm referred to agreement w/ respect ~~of~~ to cash & agreement is silent as it is ^{to be} agreed upon by both parties.

Jon also discussed April 4 ~~1998~~ 98 transactions. Shipping documents available (BOL's) - BOL's say ship to Corelli warehouse in Bridgewater NJ. Receivers from Intrac show rec'd in Loma Warehouse (indep. warehouses). Totowa, NJ.

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4/98 trans. BOL's look like re-written from an Aug. date. a small piece was shipped in Aug. Do not have original BOL's - only faxes/copies.

In PY. Co. prepared confirm that there was only barter credits & didn't mention cash which was inconsistent w/ agreement of cash & credits.

2 sets of transaction - sale & acctg for quarters & cash, ultimate valuation since no longer cash -

In PY. said they would fully utilize credits. no BOL's -

Jim David says we don't understand substance of trans. and 4/99 amendment further tries to clarify shipping terms and extends expiration date.

Question - Whether any barter transaction should be recognized and valued? J.D. unable to determine FV on date of transaction thus S/B valued @ ϕ .

B. Redwood - Credits & Relationship.

- RP as Mark serves on Board & owner of Redwood

- CY increased use of credits.

- 2 credits - \$/m bus. interr. & \$600K volume

incentive credit - recorded Q4. Co. learned about them when they reconciled accts @ y/e.

Co. explained reasons for \$/m relates to credits pd to its customers & represents compensation booked Q4 Co. suggesting now Q3. 650K incentive also booked Q4 but S/B Q3. Not known

until rec. done. Not alot of linkage to credits made by Co. Compared to \$/m credit. Dated 11/1 rec'd April backsep.

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- \$650K incentive relates to an achievable target and we have a Qtr. question. The \$650K relates to a May 98 agreement not surfaced until April 99.
- # of other credits in Q3 for \$2.5m - 500-600K for credit dating back to PV for freight Redwood agreed to reimburse Candia's.
- \$1.3m purchase credits for mis-sized goods +
- \$700K for chgsks rec'd from Co. customers.
- Questions ① \$500K freight S/B in PV?
- ② \$1.3m of mis-sized products - any acctg for chgsks to its customers
- ③ \$700K relates to chgsks reimbursed - need to know if any different from \$/m chgsks.
- ④ R nature of trans.
- ⑤ Lack of evidence as to Qtr it belongs to
- ⑥ Dramatic inc in credits in Q3, Q4
- ⑦ Most suppliers send stmts + apply pymts to invoice - Co. does on acct so can't see appl. of credits - one large rolling balance
- In Q4 Redwood + Co. agreed to build a design room for \$2.1m @ same time \$1,650 credit. They made pymt of \$1,650 for \$2m purchase of fixed assets - Co. says coincidence - Questioning are credits realizable and when s/b recorded.
- JD states - obtained Redwood agreement this wk. Receiving \$2m of credits for next 5 years from Redwood @ same time were paying \$2m Fixed assets. Could be an acceleration of income.

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- Want to test existence of fixed assets
- Need audit evidence for when & realization on Redwood Credits.

C. Quarters

- What Qtrs does barter belong in?
- Credits - which Qtrs
- Chargebacks - " "

Disbursements

- Chargebacks are rec'd for returned products, etc, markdown allow, advertising allow,
- You discussed Chgbks by quarter in \$
- Dramatic skewing to Q4
- Co. discussed valid reasons as to why most Q4
- We ? whether, doing brief analysis, some of \$9.5 belongs to P2 & we don't know which one
- Some belong to Q3 & prior to that
- Co. preparing analysis to determine qtrs
- Incremental 3.4m in Q4 that ~~depends~~ may belong to P2


3. Bongo Royalty

- Co. purchased Bongo - dispute on royalty pymts & adv. Bongo was to provide. ??'s acctg for settlement. - JD states if liab extinguished as part of acquisition is it purchase price acctg or forgiveness of debt?

4. Recommendations

- Visit w/ committee & tell of our concerns
- Have Co. seek legal advice to focus on 10/98 barter trans & others, Redwood credits & Qtrs each of which described w/ potential

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- of illegal acts - SEC may consider some of these as illegal. Rev. recy & better trans & mgt of earnings & Othly, repts are SEC focus & believe its prudent that Co. look @ this, - also long term transaction
- Based on findings, evidence may have scope limitation
 - What audit end can Co. support these topics as well as review to be performed

NASDAQ has halted trading until some filing is made as to where the Co. stands. The FS for 98 & Othly may not be relied upon so indefinite suspension of trading.

- JD also mentioned debt default and whether another press release needs to be made. Mittman says no add'l damages to be made since halted trading anyway.
- Neil asked what can be done to get opinion final.

At the conclusion of the meeting, the Board agreed to appoint a Special Committee to follow up on our recommendations. This committee will be composed solely of Barry Emmanuel, the only independent Board member. He has commented that the Company has agreed to hire Squadron, Ellenoff Plesent + Sheinfeld, LLP as the attorneys to lead the investigation and that the investigation would commence immediately. Squadron inquired if they could use our workpapers to which we agreed w/ appropriate access letters.

Prepared by

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Date

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